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December 20, 2005

VIA HAND DELIVERY

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, MA 02110

Re: *Petition of Cambridge Electric Company and Commonwealth Electric Company requesting approval of their 2005 Transition Cost Reconciliation Filing D.T.E. 05-89 – INITIAL COMMENTS OF THE CAPE LIGHT COMPACT*

Dear Secretary Cottrell:

We represent the Cape Light Compact, a municipal aggregator under G.L. c. 164, § 134, that consists of the towns of Aquinnah, Barnstable, Bourne, Brewster, Chatham, Chilmark, Dennis, Edgartown, Eastham, Falmouth, Harwich, Mashpee, Oak Bluffs, Orleans, Provincetown, Sandwich, Tisbury, Truro, West Tisbury, Wellfleet, and Yarmouth, and the counties of Barnstable and Dukes County, acting together as the Cape Light Compact (the "Compact"). The Compact is organized through a formal Inter-Governmental Agreement signed by all of the towns, as well as Barnstable and Dukes counties, pursuant to G.L. c. 40, § 4A.

On December 2, 2005, pursuant to G.L. c. 164, § 1(A) and 220 C.M.R. § 11.03(4)(e), Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth") (collectively, "the Companies") filed with the Department of Telecommunications and Energy (the "Department") their 2005 reconciliation filing (the "2005 Filing"), which consists of the reconciliation of transition, transmission, standard offer and default service costs and revenues, and proposed updated charges and tariffs to be effective January 1, 2006.

For 2006, the Companies propose the following: (1) average transition charge of $0.01723 per kilowatthour ("KWH") for Cambridge, and $0.02532 per KWH for Commonwealth; (2) average transmission charge of $0.02527 per KWH for Cambridge, and $0.00673 per KWH for Commonwealth; and (3) a default service adjustment factor of $0.00245 per KWH for Cambridge and $0.00506 per KWH for Commonwealth.

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For the reasons set forth below, the Compact wishes to register its objection to immediate approval of the 2005 Filing and to request that in this or another appropriate proceeding, the Department update its policy on default service adjustments to be consistent with other Department orders and developments in the competitive retail market.

I. REVIEW AND APPROVAL OF THE 2005 FILING SHOULD BE STAYED PENDING RESOLUTION OF D.T.E. 05-85

On December 6, 2005, the Department received a Joint Motion for Approval of Settlement Agreement (the "Motion") of Boston Edison Company, Cambridge, Commonwealth (collectively, "NSTAR Electric"), NSTAR Gas Company (together with NSTAR Electric, "NSTAR"), the Attorney General of Massachusetts, the Low-Income Energy Affordability Network and Associated Industries of Massachusetts (collectively, the "Settlement Parties"). The Motion seeks approval of a Settlement Agreement (the "Settlement") that intends to resolve certain issues with regard to a base rate case that NSTAR was planning to file with the Department. Among other things, the Settlement promises a temporary reduction in the transition charge effective January 1, 2006 by 0.0907 cents per KWH. The Settlement Parties claim that the Settlement would result in a temporary net reduction of base rates of 0.092 cents per KWH for Commonwealth residential customers (46 cents per month for an average household consuming 500 KWHs a month). D.T.E. 05-85, Exh. NSTAR-19 (Settlement) Rate Design Models at 1. The Motion states that the Settlement will be withdrawn if the Department fails to approve the Settlement in its entirety by December 30, 2005.

If the Department considers and separately approves the 2005 Filing and the Settlement, the apparent result will be that the temporary reduction in the transition charge promised in the Settlement will be reduced by nearly 20% to 0.07367 (i.e., 0.0907 – 0.01703) cents per KWH, making the "rate relief" promised in the Settlement even more illusory than it already is.[1] Moreover, if the 2005 Filing is approved, the already miniscule average 46 cents per month of rate relief promised in the Settlement will instead be transformed into a *net increase* of roughly $1.00 per month for an average household in Commonwealth's service territory.

The Compact respectfully submits that an appropriate solution is for the Department to stay this proceeding until it has reviewed the Settlement. Presumably, this would also give the Settlement Parties an opportunity to amend the Settlement to deal as well with the rate increases that the Companies are requesting in this proceeding.

[1] For a preliminary discussion of why the Settlement merely creates the illusion of rate relief for consumers, please see the Compact's letter, dated December 15, 2005, filed in D.T.E. 05-85.

II. THE COMPANIES' PROPOSED DEFAULT SERVICE ADJUSTMENT SHOULD BE REJECTED PENDING REEXAMINATION OF A PROCESS THAT ALLOWS FOR ANTI-COMPETITIVE BELOW-MARKET PRICING OF DEFAULT SERVICE THAT IS INCONSISTENT WITH LEGISLATIVE INTENT AND OTHER DEPARTMENT ORDERS

A. The Default Service Adjustment Process Creates Significant Anti-competitive Market Distortions and Should Be Reexamined for the Post-Standard Offer Period

The legislature did not intend that default service supplant or thwart competitive retail generation service. In enacting Chapter 164 of the Acts of 1997 (the "Electric Restructuring Act" or "Act"), the legislature clearly intended that *competitive* retail service should serve as the vehicle to bring the benefits of the competitive wholesale market to consumers. *See, e.g.*, St. 1997, c. 164 § 1(c) (providing that "ratepayers and the commonwealth will be best served by moving from (i) the regulatory framework extant on July 1, 1997, in which retail electricity service is provided principally by public utility corporations obligated to provide ultimate consumers in exclusive service territories with reliable electric service at regulated rates, to (ii) a framework under which competitive producers will supply electric power and customers will gain the right to choose their electric power supplier"). With respect to the period following the seven-year standard offer period, the Act established default service merely as a service of last resort for a customer who has failed to select a competitive supplier or whose competitive supplier fails to provide contracted services. G.L. c. 164, §§ 1 (definition of "Default Service"), 1B(b), 1B(d).

To its credit, the Department has clearly recognized that default service rates must reflect default service costs and that inclusion of default service costs in base rates paid by all customers (including customers not receiving default service) would result in an inappropriate subsidization of default service rates that would send incorrect price signals to consumers and thwart competition in the retail market. *See, e.g.*, D.T.E. 02-40-B at 14-15 (Apr. 24, 2003). Indeed, over the years since 1997 as the Department has learned more about the impact of default service policies on the development of competitive markets, the Department has determined that more stringent policies are required to avoid subsidization of default service rates. For example, in D.T.E. 02-40-B, the Department reaffirmed "the principle that default service prices should include all costs of providing default service in order to allow competitive suppliers a fair and reasonable opportunity to compete for default service customers." *Id.* at 14. And in that proceeding, the Department reexamined its then-existing policies and recognized that certain default service costs charged to ratepayers were not negligible (the Department citing an increase of $0.002 per KWH as non-negligible) and had to be reflected in default service rates. *Id.* at 14.

One serious anomaly in the Department's default service policies is the default service adjustment process. This letter will describe the history of the default service adjustment process as it applies to Commonwealth. In its proposed restructuring plan, Commonwealth proposed a default service adjustment tariff whereby Commonwealth would, in the case of an under-collection of default service costs from default service customer in one year, collect the under-recovery from *all ratepayers* in the next year. The Department approved Commonwealth's restructuring plan in D.T.E. 97-111 (Feb. 28, 1998). The Division of Energy Resources and certain competitive suppliers, as members of a technical working group, strongly objected to the default service adjustment process on the grounds that this would result in artificially depressed default service rates that would send incorrect price signals to consumers and stifle retail competition. D.T.E. 99-60-C at 11 (Oct. 6, 2000). Nonetheless, the Department rejected those arguments, taking the view that all ratepayers should be responsible for under-collection of default service costs because default service acts as "insurance" for all ratepayers should they need to use default service. *Id.* at 13. It is important to recognize that the Department's ruling in D.T.E. 99-60-C was issued during the standard offer period when there were relatively few default service customers, default service costs were therefore low and, particularly in the residential and small commercial and industrial ("C&I") markets, the use of default service was indeed relatively rare. It was unclear to what extent the Companies would make use of the default service adjustment tariff. Moreover, retail competition was predictably anemic during the standard offer period and it was unclear whether, following the end of standard offer, any incorrect price signals tolerated by the default service adjustment process would be material enough to affect the post-standard offer emergence of retail competition.

The default service adjustment process is now an outdated artifact of the immediate post-restructuring years and must be reexamined. In the wake of the termination of the standard offer period on March 1, 2005, except on Cape Cod and Martha's Vineyard, the distribution companies have found themselves providing default service to the vast majority of residential and small C&I customers. The Companies never used the default service adjustment process for the years prior to 2005; the 2005 Filing is the first opportunity for the Department to examine how the Companies will use the adjustment process in the post-standard offer years and what effect that will have on the emergence of retail competition. And it is now manifestly clear that the default service adjustment process can and will have a very material effect on retail competition in general and the continued success of the Compact's and any other municipal aggregation program.

Consider the interplay of retail service rates in 2005. The 2005 retail service rate offered by the Compact's competitive supplier to residential customers who are part of the Compact's municipal aggregation program is $0.07132 per KWH. Commonwealth's default service rate in effect for March 2005 for residential customers was $0.07133 per KWH. A customer comparing these two prices might well conclude that there is no significant price difference between default service and competitive supply service offered through the Compact's program. But if the costs

represented by the Commonwealth's proposed default service adjustment for 2005 had been in the default service rate to begin with, Commonwealth's March 2005 residential default service rate would have been at least $0.07639 per KWH ($0.07133 + $0.00506) – *a price that would have been 7.1% higher than the Compact's competitive supply price.* That is a significant difference and indicates that the below-market rates sanctioned by the default service adjustment process pose a significant threat to retail competition and municipal aggregation in Massachusetts.

But these numbers do not even tell the whole story. The default service adjustment that Commonwealth wishes to collect from all ratepayers in 2006 represents an aggregate under-recovery of default service costs in the amount of $20,033,000. D.T.E. 05-89, Exhibit COM-CLV-5 at 1. Even if the default service adjustment process currently allows Commonwealth to collect unrecovered default service costs that were prudently incurred, collectible under-recoveries should only include those resulting from significant and unexpected changes in costs or customer load. (Note that under-recoveries due to bad debt must now be included in default service rates, not base rates. D.T.E. 02-40-B at 17.) In other words, the fact remains that in the first instance Commonwealth was under a clear legal obligation to incorporate all default service costs into default service rates. What would have happened if Commonwealth did what it was supposed to do? If Commonwealth had incorporated the unrecovered $20.033 million in the sale of the 1,781.440 million KWHs of default service sold to customers in 2005, D.T.E. 05-89, Exh. COM-CLV-5 at 1, Commonwealth's default service rate would have been increased by an average of $0.011245 per KWH. In other words, the true residential default service price in March 2005 might have been roughly $0.08258 per KWH instead of $0.07133 per KWH. *In other words, the true default service price would have been roughly 16% above the 2005 residential retail service rate available from the Compact's competitive supplier.* Clearly, the default service adjustment process can create significant negative market consequences that cannot possibly have been intended by or acceptable to the Department.

If the Department approves the proposed default service adjustment factor for inclusion in 2006 rates without modification, the result would be imposition of an unwarranted multi-million dollar penalty on the roughly 183,000 customers in the Compact's competitive supply program and the many other competitive supply customers on Cape Cod and Martha's Vineyard who are meeting the goals and obligations of the Restructuring Act by participating in the competitive marketplace.

The Compact recognizes that another proceeding may provide a more appropriate forum for reexamination of the default service adjustment process but the Compact respectfully requests that, if that is the Department's preferred way of proceeding, the Department identify or initiate such a proceeding so that this important issue is addressed in a timely fashion. The proceeding in D.T.E. 05-85 may well be the most appropriate current proceeding in which to address this issue. The Settlement at issue in that proceeding purports to resolve issues that

would have arisen in a general rate case and reexamination of the Companies' default service adjustment tariff would certainly be appropriate, if not necessary, in a general rate case.

B. Even in the Absence of a Reexamination of the Adjustment Mechanism, the Default Service Adjustment Requested in the 2005 Filing Should Be Carefully Scrutinized

Even if the Department is willing to maintain the current default service adjustment process and tolerate anti-competitive market distortions, the Compact respectfully requests that the Department apply all appropriate scrutiny to the Companies' request for a default service adjustment. The questions that should be answered in the Department's review include the following:

- Have the Companies demonstrated that their unrecovered 2005 default service costs were in fact *prudently* incurred costs? (The Companies should have no right to collect costs that were not prudently incurred, such as costs related to risks that would ordinarily be shouldered by a wholesale supplier.)

- Have the Companies demonstrated that their unrecovered 2005 default service costs do not include cost items (*e.g.*, unrecovered bad debt) that clearly cannot be recovered in base rates?

- Have the Companies adequately explained why they failed to recover their unrecovered 2005 default service costs and demonstrated that the under-recovery was due to factors beyond their control?

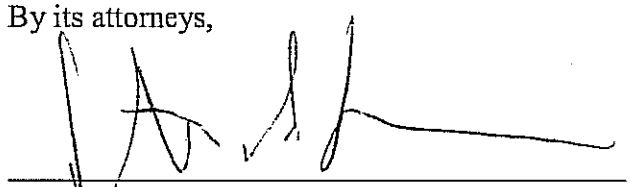
Based on the Compact's review, it does not appear that the 2005 Filing even attempts to answer these questions.

The Compact appreciates the opportunity to submit the foregoing comments.

Sincerely,

THE CAPE LIGHT COMPACT

By its attorneys,



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